

PART III

Administrative, Procedural, and Miscellaneous

26 CFR 601.601: Rules and regulations
(Also, Part I, § § 446, 451; 1.446-2, 1.451-1)

Rev. Proc. 2007-33

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SECTION 1. PURPOSE

This revenue procedure provides the exclusive procedure by which a taxpayer described in SECTION 3 may obtain the Commissioner's consent to change its method of accounting for uncollected interest (other than interest described in § 1.446-2(a)(2) of the Income Tax Regulations) to the safe harbor method provided in SECTION 4 of this revenue procedure.

SECTION 2. BACKGROUND

.01 For certain types of interest, § 1.446-2 provides rules for determining the amount of interest that accrues during an accrual period and the portion of a payment that consists of accrued interest. For descriptions of the types of interest (*e.g.*, original issue discount) to which the § 1.446-2 accrual rules do not apply, see § 1.446-2(a)(2).

.02 Section 1.446-2(b) provides that "qualified stated interest" accrues ratably over an accrual period (or periods) to which it is attributable and accrues at the stated rate for the period (or periods). In general, "qualified stated interest" is stated interest that is unconditionally payable in cash or in property (other than debt instruments of the issuer) at least annually at a single fixed rate that appropriately takes into account the length of the interval between payments. See § 1.1273-1(c).

.03 In the case of interest other than "qualified stated interest," § 1.446-2(c) provides that the amount of interest that accrues for any accrual period is determined under rules similar to those in the regulations under sections 1272 and 1275 of the Internal Revenue Code for the accrual of original issue discount (subject to the modifications set forth in § 1.446-2(d)).

.04 Section 1.446-2(e) provides that each payment on a loan (other than

payments of additional interest or similar charges with regard to amounts not paid when due) is treated as a payment of interest to the extent of the accrued but unpaid interest (determined under §1.446-2(b) and §1.446-2(c)) as of the date the payment becomes due.

.05 Section 1.446-2(a)(1) provides that a taxpayer determines the taxable year in which to include an amount of accrued interest (determined under § 1.446-2(b) or § 1.446-2(c)) in gross income under the taxpayer's regular method of accounting.

.06 Rev. Rul. 2007-32, page ____ of this Bulletin, requires an accrual method bank with a reasonable expectancy of receiving future payments on a loan to accrue interest in the taxable year in which the right to receive the interest becomes fixed, notwithstanding bank regulatory rules that prevent accrual of the interest for regulatory purposes. The ruling also provides guidance as to the period in which a taxpayer that has elected the conformity method of accounting under § 1.166-2(d)(3) can treat uncollected interest as worthless.

.07 APPENDIX 5A of Rev. Proc. 2002-9, 2002-1 C.B. 327, modified and clarified by Announcement 2002-17, 2002-1 C.B. 561, modified and amplified by Rev. Proc. 2002-19, 2002-1 C.B. 696, amplified, clarified, and modified by Rev. Proc. 2002-54, 2002-2 C.B. 432, states that "for interest to be determined uncollectible, the taxpayer must substantiate, taking into account all the facts and circumstances, that it has no reasonable expectation of payment of the interest." APPENDIX 5A of Rev. Proc. 2002-9 also states that the "substantiation requirement is applied on a loan by loan basis."

.08 Substantiation of uncollectible interest using a loan-by-loan facts and circumstances methodology can be administratively burdensome and impractical,

particularly for smaller unsecured loans. For example, a bank may have a significant number of consumer loans. For these loans, the bank's loan files often may not contain updated information regarding the debtors' financial condition or the value of the collateral, if any, securing the loans.

SECTION 3. SCOPE

This revenue procedure applies to a "bank" as defined in § 1.166-2(d)(4)(i) that—

- (1) uses an accrual method of accounting to determine its taxable income for federal income tax purposes,
- (2) is subject to supervision by Federal authorities, or by state authorities maintaining substantially equivalent standards, and
- (3) has uncollected interest other than interest described in § 1.446-2(a)(2).

SECTION 4. SAFE HARBOR METHOD OF ACCOUNTING FOR UNCOLLECTED INTEREST

.01 *Safe Harbor Method.* Under the safe harbor method of accounting provided by this SECTION 4, a bank determines for each taxable year the amount of uncollected interest (other than interest described in § 1.446-2(a)(2)) for which it is considered to have a reasonable expectancy of payment by multiplying: (1) the total accrued (determined under § 1.446-2) but uncollected interest for the year by, (2) the bank's "recovery percentage" (determined under paragraph .02 of this SECTION 4) for that year. Solely for purposes of this safe harbor, the bank is not considered to have a reasonable expectancy of payment for the excess, if any, of the accrued but uncollected interest over the expected collection amount determined using the bank's recovery percentage. The bank includes in gross income the portion of accrued but uncollected

interest for which it has a reasonable expectancy of payment. The bank excludes from income the portion of accrued but uncollected interest for which it has no reasonable expectancy of payment.

.02 *Recovery Percentage.* (1) Subject to the limitations and conditions in subparagraphs (2) – (4) of this SECTION 4.02, a bank determines its recovery percentage for each taxable year by dividing—

(a) total payments that the bank received on loans (including principal and interest) during the 5 taxable years immediately preceding the taxable year (or, with the approval of the Commissioner, a shorter period if the bank has less than 6 years of collection experience, *i.e.*, the taxable year and the 5 immediately preceding taxable years), by

(b) total amounts that were due and payable to the bank on loans during the same 5 (or fewer) taxable years.

(2) The recovery percentage cannot exceed 100 percent.

(3) The recovery percentage must be calculated to at least four decimal places.

(4) The data used in the recovery percentage must take into account acquisitions and dispositions as follows:

(a) If a bank acquires the major portion of a trade or business of another person (predecessor) or the major portion of a separate unit of a trade or business of a predecessor, then in applying this revenue procedure for any taxable year ending on or after the acquisition, the data from preceding taxable years of the predecessor attributable to the portion of the trade or business acquired, if available,

must be used in determining the bank's recovery percentage.

(b) If a bank disposes of a major portion of a trade or business or the major portion of a separate unit of a trade or business, and the bank furnished the acquiring person the information necessary for the computations required by this revenue procedure, then in applying this revenue procedure for any taxable year ending on or after the disposition, the data from preceding taxable years attributable to the disposed portion of the trade or business may not be used in determining the bank's recovery percentage.

SECTION 5. EXAMPLE

.01 *Facts.* Bank X is a calendar year taxpayer that determines its taxable income using an accrual method of accounting. For 2007, Bank X's accrued but uncollected interest (determined under § 1.446-2) is \$51,600. Bank X uses the safe harbor method of accounting described in SECTION 4 of this revenue procedure to determine the amount of uncollected interest for which the Bank has a reasonable expectancy of payment. During the 5 immediately preceding taxable years, Bank X received \$73,048,313 of payments on all of its loans. During the same 5-year period, \$74,900,705 was due and payable on the loans.

.02 *Analysis.* (1) To determine the portion of the accrued but uncollected interest for which there is a reasonable expectancy of payment, Bank X first calculates its recovery percentage for 2007. Bank X determines its recovery percentage by dividing the \$73,048,313 of payments received during the 2002-2006 period by the \$74,900,705 that was due and payable during the same period. Bank X's 2007 recovery percentage is 97.5269% [$\$73,048,313 \div \$74,900,705 = 97.5269\%$]. Bank X determines the portion

of the uncollected 2007 interest for which it is considered to have a reasonable expectancy of payment by multiplying the \$51,600 of accrued but uncollected interest for that year by the 97.5269 recovery percentage. Bank X has a reasonable expectancy of payment for \$50,323.88 of the uncollected 2007 interest [$\$51,600 \times 97.5269\% = \$50,323.88$]. Bank X includes the \$50,323.88 of uncollected 2007 interest in gross income for 2007.

(2) Bank X is considered not to have a reasonable expectancy of payment for \$1,276.12 of the uncollected 2007 interest ($\$51,600 - \$50,323.88 = \$1,276.12$). Bank X excludes \$1,276.12 of the uncollected 2007 interest from its 2007 gross income.

SECTION 6. ADOPTION OF SAFE HARBOR METHOD OF ACCOUNTING

.01 Any change to the safe harbor method provided in SECTION 4 of this revenue procedure is a change in method of accounting to which the provisions of section 446 and section 481, and the regulations thereunder, apply. Under § 1.446-1(e)(2)(i), a taxpayer generally must secure the consent of the Commissioner before changing a method of accounting for federal income tax purposes. Section 1.446-1(e)(3)(ii) authorizes the Commissioner to prescribe administrative procedures setting forth the terms and conditions necessary to obtain consent to change a method of accounting.

.02 If a bank with less than 6 years of collection experience wants to change its method of accounting for uncollected interest to the safe harbor method provided in SECTION 4 of this revenue procedure, the bank is required to follow the provisions of Rev. Proc. 97-27, 1997-1 C.B. 680 (or its successor), as modified and amplified by Rev. Proc. 2002-19, as amplified and clarified by Rev. Proc. 2002-54, except that the scope

limitations in section 4.02(2) through (6) of Rev. Proc. 97-27 do not apply to a bank that makes the change for either its first or second taxable year ending on or after December 31, 2006.

.03 If a bank with 6 or more years of collection experience wants to change its method of accounting for uncollected interest to the safe harbor method provided in SECTION 4 of this revenue procedure, the bank is required to follow the automatic change in method of accounting provisions of Rev. Proc. 2002-9 (or its successor), with the following modifications:

(1) the scope limitations in section 4.02 of Rev. Proc. 2002-9 do not apply to a bank that makes the change for either its first or second taxable year ending on or after December 31, 2006; and

(2) the designated automatic accounting change number for changes in method of accounting made pursuant to the revenue procedure is 108.

SECTION 7. REQUEST FOR COMMENTS

The Internal Revenue Service requests comments on this revenue procedure. In particular, comments are requested regarding the appropriate treatment of payments received in future years. For example, comments are requested regarding how to determine the portion, if any, of a payment attributable to amounts that the bank excluded from gross income. All comments should be submitted by August 20, 2007, to:

Internal Revenue Service
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044
Attn: CC:PA:T:CRU m(FIP)

Room 5529

Alternatively, comments may be submitted electronically directly to the Service via the following e-mail address: Notice.comments@irscounsel.treas.gov. Please include “Rev. Proc. 2007-33” in the subject line of any electronic communication. All materials submitted will be available for public inspection and copying.

SECTION 8. EFFECTIVE DATE

This revenue procedure is effective for tax years ending on or after its publication.

SECTION 9. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 2002-9 is modified and amplified to include the accounting method change provided by this revenue procedure.

DRAFTING INFORMATION

The principal author of this revenue procedure is Timothy Sebastian of the Office of the Associate Chief Counsel (Financial Institutions and Products). For further information regarding this revenue procedure, contact Mr. Sebastian (202) 622-7417 (not a toll-free call).

